99TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
99-966

AUTHORIZING THE CONSTRUCTION BY THE SECRETARY OF AGRICULTURE OF A SALINITY LABORATORY AT RIVERSIDE, CA

OCTOBER 3, 1986.—Committed to the Committee on the Whole House on the State of the Union and ordered to be printed

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Mr. DE LA GARZA, from the Committee on Agriculture, submitted the following

REPORT

[To accompany H.R. 5215]

[Including the Congressional Budget Office cost estimate]

The Committee on Agriculture, to whom was referred the bill (H.R. 5215) to authorize the construction by the Secretary of Agriculture of a salinity laboratory at Riverside, CA, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

BRIEF EXPLANATION

H.R. 5215 provides that there are authorized to be appropriated, beginning in fiscal year 1987, such sums as may be necessary for the planning, construction, and acquisition, by the Secretary of Agriculture (acting through the Agricultural Research Service), of buildings and equipment to establish a salinity laboratory to be located at Riverside, California. Moneys appropriated would remain available without fiscal year limitation.

PURPOSE AND NEED FOR THE LEGISLATION

Although irrigated land comprises less than one-eighth of the land cultivated in the United States, it produces, on a value basis, more than one-quarter of our food and fiber. However, the river and well waters used for irrigation commonly contain natural salts such as sodium, calcium, magnesium, chloride, sulfate, and nitrate dissolved from geologic materials with which the waters have come in contact. Evaporation and plant transpiration of irrigation water

91-006 O

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leaves high concentrations of salt residues in the fields. If allowed to accumulate in the root zone, salts reduce yields limiting transpiration, damaging plant tissue, or impeding water and root penetration. History records that several early civilizations based on irrigation agriculture eventually failed because of salinity problems.

Presently, about one-third of the irrigated land in the United States contains sufficient salt to impair crop growth to some degree. It is estimated that excess soil salinity is a potential hazard on at least half of all irrigated areas. In addition, many non-irrigated croplands, mainly in semi-arid States, contain levels of salt that decrease crop yield.

In California's San Joaquin Valley, salinity has reduced crop yields on 400,000 acres at an annual cost of $31 million in lost agricultural productivity. If the problem remains unchecked, such losses are projected to total $321 million annually and claim another 1 million acres of California cropland by the year 2000.

In 1928, a laboratory was established in Riverside, California to conduct research on water quality problems with emphasis on the toxicity of boron to plants. The original facility, named the Rubidoux Laboratory, was administered by the Western Irrigation Agricultural Division of the Bureau of Plant Industry. Meetings of representatives of the United States Department of Agriculture and the directors of the Agriculture Experiment Stations of 11 Western States laid the groundwork for the decision to establish a laboratory devoted to the study of salinity. In 1937, the United States Regional Salinity Laboratory was established by the Bureau of Plant Industry. The number of cooperating Agricultural Experiment Stations was increased in 1951 to include seven other Western States. The name of the facility was then changed to the United States Salinity Laboratory.

The mission of the United States Salinity Laboratory is to develop technologies and practices to prevent or solve salinity problems in agriculture production by investigating basic principles of crop production and resource protection under conditions of excess soluble salts in soil and water. The program at the laboratory involves the combined efforts of three cooperative research sections: soil-water chemistry, plant sciences, and soil physics. The laboratory staff consists of 15 scientists supported by an annual operating budget of $2.1 million.

According to the Department of Agriculture, nearly all the buildings at the current laboratory were constructed during the period from the late-1930s to the mid-1960s and need to be either replaced or renovated. Some essential specialized components, including lysimeters and plant culture beds, have deteriorated because of long usage and must be replaced. In addition, the current laboratory is located in a residential area across town from the University of California and is highly subject to urban pressures.

The purpose of H.R. 5215 is to provide an authorization for appropriations for the Department of Agriculture to construct a new salinity laboratory at Riverside, California. The laboratory will continue to develop technologies and practices to prevent or solve salinity problems in agricultural production.

SECTION-BY-SECTION ANALYSIS

H.R. 5215 contains one section that provides that, notwithstanding section 1431(a) of the Food Security Act of 1985, there are authorized to be appropriated beginning in the fiscal year ending September 30, 1987, such sums as may be necessary for the planning, construction, and acquisition, by the Secretary of Agriculture (acting through the Agricultural Research Service), of buildings and equipment to establish a salinity laboratory to be located at Riverside, California. Moneys appropriated under the bill would remain available without fiscal year limitation.

Section 1431(a) of Public Law 99-198 (The Food Security Act of 1985) provides an authorization for appropriations for each of the fiscal years ending September 30, 1988, through September 30, 1990, for such sums as may be necessary for the planning, construction, acquisition, alteration, and repair of buildings and other public improvements (including the cost of acquiring or obtaining rights to use land) of or used by the Agricultural Research Service, except that—

(1) the cost of planning any one facility must not exceed $500,000; and

(2) the total cost of any one facility must not exceed $5,000,000.

COMMITTEE CONSIDERATION

Hearings

The Subcommittee on Department Operations, Research, and Foreign Agriculture met September 24, 1986, to hold a public hearing on H.R. 5215, introduced by Mr. Brown of California, a member of the Subcommittee.

Testifying at the hearing were the Honorable Alfred A. McCandless, a Member of Congress from California; Dr. Terry B. Kinney, Administrator, Agricultural Research Service; Mr. Lowell N. Lewis, Director, University of California Statewide Agricultural Experiment Station; Mr. Theodore L. Hullar, Chancellor, University of California at Riverside; and Mr. Les Richter, who presented a statement on behalf of the local business community in Riverside, California.

Mr. McCandless, in expressing support for the bill, stated that nearly one-third of the irrigated farmland in the United States is currently experiencing a loss of productivity due to salinity. He noted that in California's San Joaquin Valley, salinity has reduced crop yields on 400,000 acres at an annual cost of $31 million in lost agricultural productivity. If the problem remains unchecked, Mr. McCandless said, such losses are projected to total $321 million annually by the year 2000.

Mr. McCandless urged the construction of the new salinity research facility, pointing to the near obsolescence and inadequate site of the current laboratory.

Dr. Kinney, testifying on behalf of the Department of Agriculture, reaffirmed the seriousness of the salinity problem in the United States and the need to modernize the existing U.S. Salinity Laboratory. However, he said that the Administration is opposed to

the construction of a new facility. Dr. Kinney maintained that the present laboratory could be renovated for $9 million, while the cost of a new facility would be $14.8 million.

Mr. Lewis offered that a new salinity laboratory would strengthen ties and cooperative research between federal agencies and scientists at the University of California who are conducting salinity studies. The salinity problem, he noted, could claim another 1 million cropland acres in California alone over the next 14 years. A new laboratory could also examine the threat to the environment posed by the increasing accumulation of toxic trace elements in irrigation wastewater, Mr. Lewis said.

Mr. Hullar provided a brief history of the long and extensive cooperative relationship enjoyed between the University of California and the Department of Agriculture, and he cited this close relationship and the many advantages inherent in the Riverside location in urging support for the proposed new laboratory.

The last witness, Mr. Richter, attested to the very strong support within the local community and the region for proceeding with facility construction.

Subcommittee Markup

Pursuant to notice, immediately following the public hearing on September 24, 1986, the Subcommittee on Department Operations, Research, and Foreign Agriculture met in business session to consider the H.R. 5215. After a brief explanation of the bill by counsel, Mr. Bedell, Chairman of the subcommittee, asked if there were any amendments. No amendments were offered, Mr. Brown moved that H.R. 5215 be reported to the full Committee with the recommendation that the bill do pass.

In the presence of a quorum, the subcommittee agreed, by voice vote, to report H.R. 5215 with the recommendation that the bill do pass.

Committee Markup

The Committee met, pursuant to notice, in business session on October 2, 1986, to consider H.R. 5215. Mr. Brown of California explained the seriousness of the salinity problem, the purpose of the bill, and the favorable action taken by the Subcommittee in approving the bill. Counsel then briefly summarized the bill.

Mr. Marlenee asked if there were any other salinity research facilities operated by the Agricultural Research Service in the United States other than the one located at Riverside, California. Mr. Brown responded that the proposed laboratory would replace the existing facility near its current location, and that he was not aware of any other such research facilities in the United States. Mr. Marlenee pointed out that salinity is also a very serious problem in Montana, although it results not from irrigation but from seepage that occurs following rains.

Mr. Marlenee urged the Committee to recommend that research conducted at the proposed new facility have applications for addressing salinity problems throughout the United States. Without objection the Committee agreed to the following recommendation made by Mr. Marlenee.

The Committee recommends that the research carried on at the salinity laboratory in Riverside, California, include research on dry land salinity problems such as those that exist in semi-arid States (such as Montana). The Committee believes that the base of research at this laboratory should be broad enough to meet a wide range of problems, and certainly the problems of the saline seeps in Montana and other areas should be addressed. The related dry land salinity problem should benefit from the research conducted at the proposed salinity laboratory authorized by the bill.

In the presence of a quorum, the Committee agreed to report H.R. 5215 with the recommendation that the bill do pass. Without objection, the staff was authorized to make technical corrections in the bill.

ADMINISTRATION POSITION

At the time of the filing of this report, the Committee had not received a report from the U.S. Department of Agriculture concerning H.R. 5215. The views of the Administration are reflected in the Committee consideration section of this report.

BUDGET ACT COMPLIANCE (SECTION 308 AND SECTION 403)

The provisions of clause 2(l)(3)(B) of rule XI of the Rules of the House of Representatives and section 308(a) of the Congressional Budget Act of 1974 (relating to estimates of new budget authority or new or increased tax expenditures) are not considered applicable. The estimate and comparison required to be prepared by the Director of the Congressional Budget Office under clause 2(l)(3)(C) of Rule XI of the Rules of the House of Representatives and section 403 of the Congressional Budget Act of 1974 submitted to the Committee prior to the filing of this report are as follows:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, October 3, 1986.

Hon. E DE LA GARZA,
Chairman, Committee on Agriculture,
U.S. House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed H.R. 5215, as ordered reported by the House Committee on Agriculture, October 2, 1986. This bill would authorize the appropriation of such sums as may be necessary for the planning, construction, and acquisition of a salinity laboratory at Riverside, California.

Based on information from the Administration, we estimate that this laboratory would cost $14.8 million. The appropriation of this amount would result in outlays of $2.2 million in fiscal year 1987, $7.4 million in 1988, $2.2 million in 1989, and $3.0 million in 1990.

Enactment of this bill would have no effect on the budgets of State or local governments.

If you wish further details on this estimate, we will be pleased to provide them.

With best wishes,
Sincerely,

RUDOLPH G. PENNER, *Director.*

INFLATIONARY IMPACT STATEMENT

Pursuant to clause 2(l)(4) of rule XI of the Rules of the House of Representatives, the Committee estimates that enactment of H.R. 5215 will have no inflationary impact on the national economy.

OVERSIGHT STATEMENT

No summary of oversight findings and recommendations made by the Committee on Government Operations under clause 2(b)(2) of rule X of the Rules of the House of Representatives was available to the Committee with reference to the subject matter specifically addressed by H.R. 5215.

No specific oversight activities other than the hearings detailed in this report were conducted by the Committee within the definition of clause 2(b)(1) of rule X of the Rules of the House of Representatives.

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99TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
99-967

FARM CREDIT ACT AMENDMENTS OF 1986

OCTOBER 3, 1986.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. DE LA GARZA, from the Committee on Agriculture, submitted the following

REPORT

together with

ADDITIONAL AND SEPARATE VIEWS

[To accompany H.R. 5635]

[Including Congressional Budget Office cost estimate]

The Committee on Agriculture, to whom was referred the bill (H.R. 5635) to amend the Farm Credit Act of 1971 regarding interest rates charged by Farm Credit System institutions and financial operations of such institutions, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Farm Credit Act Amendments of 1986".

SEC. 2. POLICY.

Section. 1.1 of the Farm Credit Act of 1971 (12 U.S.C. 2001) is amended by adding at the end thereof the following new subsection:

"(c) It is declared to be the policy of Congress that the credit needs of farmers, ranchers, and their cooperatives are best served if the institutions of the Farm Credit System provide equitable and competitive interest rates to eligible borrowers, taking into consideration the creditworthiness and access to alternative sources of credit for borrowers, the cost of funds, including any costs of defeasance under section 4.8(b), the operating costs of the institution, including the costs of any loan loss amortization under section 5.19(b), the cost of servicing loans, the need to retain earnings to protect borrower stock, and the volume of net new borrowing. Further, it is declared to be the policy of Congress that Farm Credit System institutions take action in accordance with the Farm Credit Act Amendments of 1986 in such

91-006 O

H163-13

manner that borrowers from the institutions derive the greatest benefit practicable from that Act: *Provided,* That in no case is any borrower to be charged a rate of interest that is below competitive market rates for similar loans made by private lenders to borrowers of equivalent creditworthiness and access to alternative credit.".

SEC. 3. TERMINATION OF FARM CREDIT ADMINISTRATION APPROVAL OF INTEREST RATES CHARGED BY SYSTEM INSTITUTIONS.

(a) FEDERAL LAND BANKS.—The first sentence of section 1.7 of the Farm Credit Act of 1971 (12 U.S.C. 2015) is amended by striking out ", with the approval of the Farm Credit Administration as provided in section 4.17 of this Act".

(b) FEDERAL INTERMEDIATE CREDIT BANKS.—The second sentence of section 2.4 of the Farm Credit Act of 1971 (12 U.S.C. 2075) is amended by striking out "with the approval of the Farm Credit Administration as provided in section 4.17 of this Act".

(c) BANKS FOR COOPERATIVES.—The first sentence of section 3.10(a) of the Farm Credit Act of 1971 (12 U.S.C. 2131(a)) is amended by striking out ", with the approval of the Farm Credit Administration as provided in section 4.17 of this Act".

SEC. 4. CERTAIN TRANSACTIONS WITH RESPECT TO SYSTEM OBLIGATIONS.

Section 4.8 of the Farm Credit Act of 1971 (12 U.S.C. 2159) is amended by—

(1) inserting the designation "(a)" after the heading; and

(2) adding at the end thereof the following:

"(b) Through December 31, 1988, each bank of the System, in addition to purchasing obligations as authorized by this Act, may, with the prior approval of the Farm Credit Administration and subject to such conditions as it may establish, (1) reduce the cost of its borrowings by doing one or more of the following: (A) contracting with a third party, or an entity that is established as a limited purpose System institution under section 4.25 and that is not to be included in the combined financial statements of other System institutions, with respect to the payment of interest on the bank's obligations and the obligations of other System banks incurred before January 1, 1985, in consideration of the payment of market interest rates on such obligations, plus a premium, or (B) for the period July 1, 1986, through December 31, 1988, capitalizing interest costs on obligations incurred before January 1, 1985, in excess of the estimated interest costs on an equivalent amount of Farm Credit obligations at prevailing market rates of interest on Farm Credit obligations of similar maturities as of the date of the enactment of this subsection, or (C) taking other similar action; and (2) amortize, over a period of not to exceed 20 years, the capitalization of the premium, capitalization of interest expense, or like costs of any action taken under clause (1).".

SEC. 5. DETERMINATION OF INTEREST RATES.

Section 4.17 of the Farm Credit Act of 1971 (12 U.S.C. 2205) is amended by striking out the first sentence and inserting in lieu thereof the following: "Interest rates on loans from institutions of the Farm Credit System shall not be subject to any interest rate limitation imposed by any State constitution or statute or other laws. Such limitations are preempted for purposes of this Act.".

SEC. 6. TERMINATION OF FARM CREDIT ADMINISTRATION APPROVAL OF INTEREST RATES CHARGED ON DIRECT AND DISCOUNTED LOANS.

Section 5.17(a)(5)(A) of the Farm Credit Act of 1971 (12 U.S.C. 2252(a)(5)(A)) is amended by striking out "and on loans made or discounted by such institutions".

SEC. 7. ACCOUNTING.

Section 5.19(b) of the Farm Credit Act of 1971 (12 U.S.C. 2254(b)) is amended by striking out the second sentence and inserting in lieu thereof the following:

"Each such report shall contain financial statements prepared in accordance with generally accepted accounting principles, except with respect to any actions taken by any banks of the System under section 4.8(b), and contain such additional information as the Farm Credit Administration by regulation may require. Notwithstanding the provisions of the preceding sentence and any other provision of this Act, for the period July 1, 1986, through December 31, 1988, the institutions of the Farm Credit System may, on the prior approval of the Farm Credit Administration and subject to such conditions as it may establish, capitalize annually their provision for losses that is in excess of one-half of one percent of loans outstanding and amortize such capitalized amounts over a period not to exceed 20 years.".

Brief Explanation

H.R. 5635, as ordered reported by the Committee on Agriculture, would amend the Farm Credit Act of 1971.

It includes—

A provision under which Farm Credit System banks could, subject to prior approval and under conditions set by a Government regulatory agency (the Farm Credit Administration) reduce the cost of their borrowed money, without affecting returns to holders of System bonds, by steps including refinancing long-term debt on which they are currently paying high interest rates or capitalizing their excess interest costs. The costs involved could be amortized by System banks over a period of up to 20 years.

A provision under which Farm Credit System institutions could, subject to prior approval and under conditions set by the Farm Credit Administration, amortize over a period of up to 20 years a portion of loan losses they have sufered in recent years due to a combination of factors including the depression in farm income and farm asset values.

A provision under which Farm Credit System institutions will be given authority to set the interest rates charged to their borrowers in order to keep the System competitive with other private agricultural lenders, subject to the Farm Credit Administrations authority to oversee their fiscal soundness.

H.R. 5635 requires no expenditures of Federal funds and has no effect on the Federal budget.

Purpose and Need

THE FARM CREDIT SYSTEM

The Farm Credit System is a Federally-chartered, cooperatively owned nationwide system of banks and associations that provides credit and closely related services to farmers, ranchers, producers or harvesters of aquatic products, rural homeowners, and selected farm-related businesses. It also provides credit services to agricultural cooperatives and certain other entities. The System serves all 50 states and Puerto Rico.

The country is divided into twelve Farm Credit districts. There is, at the same location in each district, a Federal land bank, a Federal intermediate credit bank, and a bank for cooperatives. There is also a Central Bank for Cooperatives in Denver, Colorado.

The three Farm Credit banks in each district are separate legal organizations. Although the Farm Credit banks in several districts have operated with common management for many years, most districts recently adopted common management for all three banks.

The Federal land banks make loans through Federal land bank associations to producers and farm-related businesses ranging from 5 to 40 years for land and other capital purchases that can be repaid over a longer term. These loans are usually secured by a first lien on real estate.

Short- and intermediate-term credit for producers and farm-related businesses are provided by production credit associations. The funds for these loans, ranging in maturity from a single season to

15 years for special purposes, are borrowed from the Federal intermediate credit banks. PCA loans are made to cover seasonal operating expenses, land improvements, and purchases of farm equipment, livestock, storage facilities, and buildings.

The banks for cooperatives provide a complete line of credit services to agricultural and rural utility cooperatives, offering loans and leasing services tailored to their special needs, and other financial services related to cooperative activities.

The Farm Credit System Capital Corporation, established by the Farm Credit Amendments Act of 1985, administers the System self-help programs provided for by that Act. Other System service corporations perform functions, other than lending, that System banks could perform themselves.

1985 LEGISLATION

In 1985, Congress adopted legislation that significantly modified the System's basic charter, the Farm Credit Act of 1971. The Farm Credit Amendments Act of 1985 reorganized the Farm Credit Administration (FCA) so that it now functions as an arm's-length regulator of the System. It gave the agency increased regulatory powers. It established a new System institution, the Farm Credit System Capital Corporation, with power to marshal the resources of the System for purposes of "self-help"—so that financially stronger elements of the System would assist the elements experiencing financial stress. And, it authorized the appropriation of Federal funds to assist the System should its self-help resources become exhausted.

THE PROBLEM

While the provisions of the 1985 amendments were being implemented, circumstances having a heavy impact on the System moved apace. The process of recovery of the agricultural sector has been slow in coming. An ever increasing number of farmers and ranchers were unable to meet their financial obligations. This condition was, and is, particularly acute in certain regions of the country. Since the Farm Credit institutions are prohibited by law from operating as general purpose lenders (they are, with minor exceptions, restricted to lending for farm and agriculture-related purposes), they have suffered severe loan losses without being able to share in the fruits of the recovery in other areas of the economy.

To illustrate these points, production credit associations (PCAs) and Federal land banks (FLBs) are carrying more than $7.5 billion in nonaccrual farm loans that are not considered fully collectible. They hold another $5 billion in other high risk loans. Even though repayments are not currently being made on most of these troubled loans, the Farm Credit System is continuing to bear the cost of servicing its obligations to investors who have purchased bonds to finance the System's lending activities. While the System tries to practice forbearance with its borrowers, it nevertheless must meet its bills when they come due to the investing public.

The growing volume of troubled loans and continued deterioration of farmland values has finally caught up with the Farm Credit System. Last year, the System posted the largest annual loss of any

financial institution in history, nearly $2.7 billion. For the first 6 months of 1986, the System lost another $968 million, and there is little reason to believe this trend has yet to run its course.

Competing with loan losses as the major source of the System's financial stress is the high cost associated with much of its borrowings from the public. A heavy volume of System obligations of relatively long maturity was sold in the early 1980's when interest rates generally reached unprecedented levels. These obligations largely represent financing for the Federal land banks. Approximately $30.8 billion of such obligations have a weighted average maturity of 3.4 years and bear interest rates of 9 percent or higher. The average cost of System funds is 10.6 percent. This contrasts with a current bond rate of about 6 percent. The System must, of course, generate income sufficient to meet its costs of carrying this debt. It must, in turn, look to its member-borrowers for this income through the interest rates it establishes for its loans. It has been established that it is many of these same farmers who have a desperate need for some interest rate relief themselves.

This combination of high loan losses and high costs of borrowings has plunged the System into major financial stress, as portrayed by the figures summarized above.

There are other factors, too, that must be taken into account. To add to the System's problems, it is also experiencing the loss of substantial numbers of financially sound borrowers to other lenders whose terms and conditions are more attractive and who respond more quickly to the overall downward trend of interest rates.

For this and other reasons, from a peak of over $85 billion in total outstanding loans at the end of 1983, the System's loan volume fell to $61.5 billion as of June 30, 1986, and it continues to decline.

The facts are clear about what has happened to the wholesale cost of money over the past year. Five-year Treasury bills have dropped from 9.81 percent to 6.8 percent. Since August 1985, the prime rate has droped from 9.5 percent to 7.5 percent. Home mortgage rates have fallen from an average of 12.41 percent to 10.5 percent. However, during this same period, the Farm Credit System's interest rates have only dropped an average of less than 1 percent. No business organization can long survive a competitive disadvantage such as this. The System is losing too many of its profitable loans, but largely because of current circumstances, it is prohibited from reducing its interest rates to more competitive levels so it can compete for new loans and hold on to the customers it now has.

The Farm Credit Act explicitly gives the FCA a power unique among agencies that regulate financial institutions—the power to approve the interest rates charged by System banks and associations on their loans. Many System institutions have been seeking to lower their rates—but the System's regulator has not responded in a timely fashion to requests for limited interest rate reductions.

Although financially healthy System institutions have made over $1 billion available to their distressed sister institutions, further System self-help efforts recently have been frustrated. While the Capital Corporation, established by the 1985 legislation, is organized and is functioning, lawsuits filed by certain System institutions have challenged the methods and ability of the Corporation to

collect assessments from healthy institutions for redistribution to the financially stressed institutions.

The focus of some of the cases is the allegation that FCA regulations governing this subject go beyond the authority given the agency in the Farm Credit Amendments Act of 1985. Other suits challenge the assessment powers of the Capital Corporation on constitutional grounds. While none of this litigation has been finally resolved, and may well not be resolved for some time, preliminary orders of some courts have, at least for the present, caused the Capital Corporation to withhold its assessment directives. Therefore, intra-System financial assistance is not now being channeled through the Capital Corporation to those System institutions that urgently need it.

PURPOSE

H.R. 5635 is designed to address promptly and effectively each of the pressing problems described above.

First, as to interest rates on loans made by System institutions, the bill deletes from the Farm Credit Act the provisions that subject such rates to FCA approval. Thus, the establishment of interest rates—a fundamental, day-to-day business decision for any lender—will be left up to the boards of directors of System district banks. That is not to say, however, that the System will be allowed to operate free of any restraints in this area. The FCA will continue to have authority, under the so-called "safety and soundness" and "capital adequacy" provisions of current law to ensure that the System does not take actions that threaten its viability. However, the FCA will no longer have prior approval authority over the day-to-day business judgment of System boards in fixing interest rates.

It is expected, however, that the FCA will exercise its authority in a manner that is consistent with the regulations and practices of other financial regulators. This authority will permit the FCA to monitor interest rates and loan terms to ensure that System institutions are following appropriate asset/liability management practices and are not charging interest rates that are below those offered on similar loans by other private lenders to borrowers of equivalent creditworthiness and access to alternative credit. The bill in no way curtails the authority of the FCA to address poor management or lending practices; it simply provides that these problems may not be addressed through the prior approval of System interest rates.

In this connection, section 2 of the bill expresses the policy of Congress with respect to System interest rates. While this policy statement is not a provision of positive law and does not purport to constitute a formula for the determination of interest rates, it does indicate some of the factors to be taken into consideration by System policymakers not only with respect to levels of interest, but with respect to the broad objectives of H.R. 5635. Included among such factors are the provision of equitable and competitive interest rates to System borrowers, borrowers' creditworthiness and access to alternative sources of credit, the cost of funds (including the cost of other actions authorized to be taken by the bill), the operating costs of the institution (including the costs of any loan loss amorti-

zation authorized by the bill), the cost of servicing loans, the need to retain earnings to protect borrower stock, and the volume of net new borrowing. It should be clear, therefore, that the policy of Congress contemplates no "free fall" of System interest rates, and no application of the bill's remedial provisions in a fashion so as to dissipate System resources or to undercut interest rate levels generally being charged by other commercial lenders on similar loans. It is not intended, however, that System institutions having lower costs of funds and lower operating costs be precluded from charging rates that reflect their financial strength, consistent with the overall objectives of the Act.

In this regard, the bill is designed to respond to the need of System institutions to offer competitive interest rates in order to retain creditworthy borrowers and thus preserve the earnings base that over time will enable them to work out of their financial difficulties. As reflected in the policy statement, the Committee does not intend that System institutions depress earnings by charging interest rates that are below competitive market rates for similar loans from other private lenders. But it is recognized that the interest rates charged by the System must be responsive to the various competitive environments in which it operates and that ailing System institutions cannot mount a long-term financial recovery by offering noncompetitive interest rates to existing and prospective borrowers. This approach is consistent with other provisions of the bill which permit System institutions to seek approval to amortize a portion of their current excessive interest costs and loan losses over an extended period of years.

The Committee recognizes that, in certain areas of the country, the System carries the overwhelming portion of agricultural credit. In some cases, competition to the system is lacking because few commercial lenders are actively engaged in financing farmers, ranchers, and their cooperatives. While the Committee favors as much competition as possible, agricultural producers and cooperatives should not be expected to suffer unfavorable credit conditions if aggressive competition for their business does not exist.

It should also be clear that the System is to carry out the bill's provisions in such a manner that its borrowers derive from the legislation the greatest benefit practicable. So that such benefit is afforded to sorely pressed farmers in time to meet their financing needs for the 1987 crop, it is absolutely essential that the System and the FCA move swiftly to implement the bill.

H.R. 5635 also confronts the two problems discussed above that generate much of the System's financial distress—the high costs of its borrowings and the high levels of its loan losses. Unfortunately, the bill will not cure these problems. To a large extent, a true cure—the return to health of the agricultural segment of the economy—depends largely upon external factors well beyond the control of the System and its farmer-borrowers. However, the bill does not make available to the System some effective tools to help it manage, and alleviate over time, the problems that now squeeze it in an intractable vice.

In essence, use of these tools will give the System time to work off costs and losses that, if required to be recognized currently, would compound its financial woes. H.R. 5635 will allow the

System, with the prior approval of and subject to conditions set by the FCA, for the period July 1, 1986 through December 31, 1988, to capitalize the "excess" portion of its costs of borrowings and its loan losses, and amortize these amounts over a period of up to 20 years. With respect to the costs of borrowings, the "excess" for these purposes is the amount by which interest costs on System obligations incurred before January 1, 1985 exceed the estimated costs of a like amount of System securities at prevailing market rates on System obligations of like maturities as of the date of enactment of the bill, likely close to 6 percent. With respect to loan losses to be capitalized annually for calendar years 1986, 1987, and 1988, the "excess" for these purposes is the amount by which the System's provision for losses exceeds one-half of one percent of loans outstanding (historically the level of provision for losses maintained by the System). Under these measures, the System would have up to 20 years to pay these capitalized amounts.

Under the bill, the System would be relieved of none of its obligations. Holders of System securities would be paid interest and principal in full when due. However, the recognition of excess costs and losses described could be spread over up to 20 years, rather than currently. While there is, of course, a cost to these arrangements, it would be met with future System earnings over the period of the amortization.

It is contemplated that System institutions that have obtained approval from the FCA to utilize the loss accounting procedure described above may do so on a monthly or quarterly basis, in accordance with the requirements applicable to the preparation of their interim financial statements. It is not the intent of the Committee to limit the application of this provision to the year-end financial statements prepared by System institutions.

It is recognized that this treatment of costs and losses would not be consistent with generally accepted accounting principles (GAAP). The Farm Credit Amendments Act of 1985 required that System financial statements be prepared in accordance with GAAP. The bill would make an exception from this requirement with respect only to extended amortization periods that it provides for.

The Committee does not retreat from its adherence to the general principle that GAAP accounting is desirable for the System. While it believes that a limited exception is appropriate for this limited purpose, it admonishes the system and the FCA that System financial statements must fully and fairly disclose precisely what the System is doing in this regard. The public present and prospective investors, the farmer-borrowers who own the System, and Congress itself deserve no less. It is the Committee's hope and expectation that such full and fair disclosure of measures taken under statutory authority will not impair, but rather will enhance, investor confidence in the System. This should follow when it is clearly understood that such measure will increase the likelihood that the System will be able to alleviate its financial problems and continue as viable and healthy financial institution.

The Committee is convinced that the accounting changes authorized by the bill will significantly reduce the amount of financial assistance that will be required by troubled System institutions from

the Farm Credit System Capital Corporation. However, the bill is not expected either to eliminate entirely the need for healthy System institutions to share their available surplus with ailing System institutions or to impede the operations of the Farm Credit System Capital Corporation in exercising its statutory authority to administer financial and technical assistance and provide appropriate oversight to troubled institutions.

The accounting provisions of the bill are not in any way intended to relieve System institutions of the responsibility of dealing with their serious operational and financial problems. At this point it must be strongly emphasized that the System's use of the fiscal tools supplied by the bill will be subject to strict regulation. H.R. 5635 provides that these tools may be employed with the prior approval of the FCA, and subject to such conditions as the agency may establish.

Improvements in the System's financial condition, resulting from implementation of the accounting procedures permitted in this bill, should not be taken by the System as reasons to assume false confidence in its approach to future management and business decisions. This is no time for the System to resume a "business as usual" attitude, and the Committee fully expects all System institutions to operate prudently and efficiently to make wise use of the new authorities allowed under this legislation.

Furthermore, the success or failure of the new authorities permitted by H.R. 5635 depends greatly on the FCA acting in good faith to promulgate regulations implementing the bill in a timely manner. The Committee expects prompt and responsive action on the FCA's part.

CONCLUSION

The Committee has adopted the provisions of H.R. 5635 that terminate the FCA's prior approval authority over System loan interest rates because it is confident that doing so reflects appropriate business practice and regulatory activity. It has adopted other provisions of the bill relating to excessive System funding costs and loan losses with a somewhat different conviction. It favors the long-term amortization of the excess portion of these costs and losses, and the exceptions to GAAP that are involved, only in preference to the alternative courses that are available.

Those courses appear to be two in number. One is to do nothing and hope that some event may intervene to relieve the System's financial stress; the Committee rejects that course as irresponsible. The other is to undertake to obtain Federal financial assistance for the System, which the system itself has not even requested. The Committee rejects that course as being, as a practical matter, unnecessary and unlikely in view of the budget implications and the time remaining in this session of Congress. Therefore, the Committee has adopted the course of action that it believes is timely, practical, and workable. It entails no outlay from the Federal Treasury, and it gives the System the ability to manage its high funding costs and loan losses responsibly over time with full and frank disclosure.

The tools that the bill gives the System will enable it to defer—and hopefully to preclude altogether—seeking federal financial assistance. It will permit a System that for more than 50 years has been the largest and one of the most important and stable suppliers of credit to American agriculture to continue this essential role.

SECTION-BY-SECTION ANALYSIS

SECTION 1—SHORT TITLE

Section 1 provides that the bill may be cited as the "Farm Credit Act Amendments of 1986".

SECTION 2—POLICY

Section 2 will add to the "Policy and Objectives" statement in section 1.1 of the Farm Credit Act of 1971 an expression of the policy of Congress (1) that the credit needs of farmers, ranchers, and their cooperatives are best served if the institutions of the Farm Credit System provide equitable and competitive interest rates to eligible borrowers, taking into consideration the creditworthiness and access to alternative sources of credit for borrowers, the cost of funds, including any costs of debt amortization (see the analysis of section 4 below), operating costs of the institutions, including the costs of any loan loss amortization (see the description of section 7 below), the cost of servicing loans, the need to retain earnings to protect borrower's stock, and the volume of net new borrowing, and (2) that Farm Credit System institutions take action in accordance with the bill in such manner that borrowers from the institutions derive the greatest benefit practicable from it, except that in no case is any borrower to be charged a rate that is below competitive market rates for similar loans from private lenders to borrowers of equivalent creditworthiness and access to alternative credit.

It is the intent of the Committee that authority conferred on individual banks by the bill be used in an equitable and nondiscriminatory manner, so that borrower-stockholders derive the greatest practicable benefit from the Farm Credit Act. Interest rate reductions to borrower-stockholders under the bill should be in line with the purposes of and spirit underlying the cooperatively owned Farm Credit System.

Further, it is the intent of the Committee that the Farm Credit Administration act as expeditiously as practicable to carry out the provisions of the bill. It is essential that the assistance to the Farm Credit System to be provided by the bill be made available in a timely manner.

SECTION 3—TERMINATION OF FARM CREDIT ADMINISTRATION APPROVAL OF INTEREST RATES CHARGED BY SYSTEM INSTITUTIONS

Section 3 will delete from the Farm Credit Act of 1971 the provisions found in sections 1.7, 2.4, and 3.10(a) that subject, to the Farm Credit Administration approval, the loan interest rates established by the Federal land banks, the Federal intermediate credit banks, and the banks for cooperatives.

SECTION 4—CERTAIN TRANSACTIONS WITH RESPECT TO SYSTEM OBLIGATIONS

Section 4 will amend section 4.8 of the Farm Credit Act of 1971 to redesignate the existing text as subsection (a) and add a new subsection (b). New subsection (b) will authorize each bank of the Farm Credit System, through December 31, 1988 (with the prior approval of and subject to conditions established by the regulator—the Farm Credit Administration) to take measures that will permit the bank to reduce the costs of its borrowings. Each bank would be authorized to take one or more of the following actions—

(1) contracting with a third party, or with a System service organization that is established under the Farm Credit Act for the limited purposes of the bill and that is not to be included in the combined financial statements of other System institutions, with respect to payment of interest on the obligations of the bank and other System banks incurred before January 1, 1985, in consideration of the payment of market interest rates on such obligations, plus a premium;

(2) for the period July 1, 1986 through December 31, 1988, capitalizing interest costs on obligations incurred before January 1, 1985, in excess of the estimated interest costs on an equivalent amount of Farm Credit obligations at prevailing market rates of interest on Farm Credit obligations of similar maturities as of the date of the enactiment of the bill; or

(3) other similar action.

Each bank also would be authorized, again with prior approval of and subject to conditions established by the Farm Credit Administration, to amortize, over a period of not to exceed 20 years, the capitalization of the premium, capitalization of interest expenses, or like costs of any action taken under the provisions explained above.

While the Farm Credit Act presently authorizes System banks to purchase their own obligations and to make investments, section 4 will make clear that System banks may use the measures described above.

SECTION 5—DETERMINATION OF INTEREST RATES

Section 5 contains an amendment to section 4.17 of the Farm Credit Act of 1971 that conforms it with the other interest rate amendments to the Act. References to Farm Credit Administration approval of interest rates would be removed from section 4.17 while language preempting the application of State usury-type laws to loans of System institutions would be preserved.

SECTION 6—TERMINATION OF FARM CREDIT ADMINISTRATION APPROVAL OF INTEREST RATES CHARGED ON DIRECT AND DISCOUNTED LOANS

Section 6 will delete from section 5.17(a)(5) of the Farm Credit Act of 1971 a reference to Farm Credit Administration approval of interest rates on loans made or discounted by System institutions.

SECTION 7—ACCOUNTING

Section 7 will revise the provision of section 5.19(b) of the Farm Credit Act of 1971 that requires that financial statements of System institutions be prepared in accordance with generally accepted accounting principles ("GAAP"). The revision will exempt from GAAP actions taken by System banks under section 4.8(b) of the Act, to be added by section 4. It also adds a provision that states that, notwithstanding any other provisions of the Act (including the GAAP accounting requirement), System institutions, during the period of July 1, 1986, through December 31, 1988, could (on the prior approval of and subject to any conditions imposed by the Farm Credit Administration) capitalize, annually, their provision for losses that exceeds one-half of one percent of loans outstanding and amortizer the capitalized amounts over a period of not to exceed 20 years.

This would allow System institutions to capitalize the extraordinary portion of their losses incurred in the recent past. Those losses, therefore, would continue on the System books, but they would be repayable from earnings in future years.

COMMITTEE CONSIDERATION

SUMMARY OF HEARINGS

The Subcommittee on Conservation, Credit, and Rural Development of the Committee on Agriculture held a public hearing on September 18, 1986, to review the financial condition of the Farm Credit System with officials from the General Accounting Office, the Farm Credit Administration, and the System itself. Additionally, the Subcommittee reviewed and discussed various solutions to problems facing the System, including the provisions of H.R. 5497, the Farm Credit System Borrower Interest Rate Relief Act of 1986, sponsored by Chairman Jones and 138 other Members, which was the predecessor to H.R. 5635, the Farm Credit Act Amendments of 1986.

Following the testimony and discussion at the Subcommittee's hearings and after subsequent court decisions were announced, a bill, H.R. 5635, was introduced by Mr. Jones and 62 other Members. H.R. 5635 takes a more comprehensive approach than H.R. 5497 in addressing potential financial stress in the System.

At the September 18, 1986, hearing, Mr. William J. Anderson, Assistant Comptoller General, pointed out that:

> The System's financial condition significantly deteriorated in 1985, with the System incurring an operating loss of $2.8 billion; and the System could incur an operating loss of $2.9 billion in 1986, which would essentially deplete the System's remaining surplus;
>
> The severe difficulties encountered by the System in the recent past would continue and that little evidence exists pointing to improvements in the agricultural economy;
>
> The System's competitiveness as an agricultural lender appears to be weakening;

The primary problems facing the system are twofold: (1) problems with its loan portfolio and (2) the high cost of its dept; and

Neither the System nor the Farm Credit Administration have effectively addressed the System's high exposure to interest rate risk.

Mr. Frank Naylor, Chairman of the Farm Credit Administration, did not provide a written statement for the hearing.

Mr. Naylor orally pointed out that:

The problems being faced by the System today largely are a result of a substantial paydown on the agricultural debt across the entire financial sector;

The Farm Credit Administration does not set individual interest rates and has no interest in doing so; and

The only reason the Farm Credit Administration is involved at all with interest rates at this point is that capital adequacy regulations are in the process of being finalized and will go into effect before the end of the year.

Mr. Grant Lucas, Chairman of the Board of the Farm Credit Corportation of America, pointed out that:

Up until very recently the Farm Credit Administration took months to make a decision on a district's request to lower interest rates and sometimes did not respond at all to such requests;

The Farm Credit System, not the Government regulator (the Farm Credit Administration), must have the authority to make fundamental business decisions such as the setting of interest rates; and

Under voluntary agreements entered into by System Banks, the FCS has already shared almost $1 billion in capital in assistance to financially stressed banks.

Mr. H. Brent Beesley, Chief Executive Officer of the Farm Credit Corporation of America, pointed out that:

The System reported a loss of $968 million for the first six months of 1986, compared to a loss of $2.7 billion in 1985;

The losses of the System are a function of three primary factors, (1) large additions to the allowance for loan losses, (2) increasing amounts of nonaccrual loans, and, (3) the high cost of the System's debt;

The continued regulatory control of the Farm Credit Administration over System interest rates is preventing the System from implementing its prepared model interest rate pricing program, thus making it a noncompetitive lender; and

The Farm Credit Administration has issued arbitrary regulations, effectively prohibiting many of the System's most able and dedicated leaders from serving on the Capital Corporation Board of Directors.

Mr. Beesley also provided the Subcommittee with the Farm Credit System Strategic and Business Plan that details the System's long-term direction as well as its goals and objectives for 1986 and 1987.

Mr. Gene L. Swackhamer, Chairman of the Board of Directors of the Farm Credit System Capital Corporation, explained the organization, philosophy, and policies of the Capital Corporation, which

was established by the Farm Credit Amendments Act of 1985, to oversee the System-wide financial self-help effort. He pointed out that the Capital Corporation would exercise a fiduciary responsibility for the sound and constructive use of resources from contributing System institutions and that it would ensure that receiving institutions employ funds in a manner that will help them remain viable financial organizations. Capital Corporation management has been directed to respond promptly to every request for assistance from System institutions.

Mr. Hugh R. Macklin, Chief Executive Officer of the Farm Credit System Capital Corporation, explained the operations of the Capital Corporation. He explained that a request for assistance by a System institution is followed up with a complete review of the condition and needs of the requesting bank, which involves 15 to 20 staff people and about 3 weeks time. The Board of Directors then decides on the request for funds and, if it decides affirmatively, structures an agreement to provide the Capital Corporation with adequate controls to supervise the use of the funds. The Capital Corporation also can assist System institutions by purchasing nonaccruing assets and has done so in order to assist two district banks. He indicated the Capital Corporation is in various stages of preparing agreements to provide funding to six Farm Credit System banks.

Committee Markup

On Thursday, October 2, 1986, Chairman de la Garza convened the Committee on Agriculture in an open business meeting called to consider emergency legislation amending the Farm Credit Act of 1971, contained in H.R. 5635, the Farm Credit Act Amendments of 1986.

Mr. Jones of Tennessee, Chairman of the Subcommittee on Conservation, Credit, and Rural Development and sponsor of the bill, explained the need for the legislation and that it continued to embrace the idea that the Farm Credit System must do all in its power to help itself before further congressional consideration can be given to Federal assistance.

Mr. Jones explained that the authorities contained in H.R. 5635 were more practical than preferable but necessary if Federal expenditures were to be avoided. Action on the legislation, he said, was imperative to address the financial problems of the System and its borrowers before adjournment of the 99th Congress.

A discussion ensued among the Committee Members, Committee Counsel, and General Counsel of the Farm Credit Administration, Fred Medero.

Mr. Glickman noted that, while he was a sponsor of the bill, he had several concerns, including a general concern that the provisions of the bill were perhaps too broad and discretionary.

Mr. English expressed his approval of the portion of the bill that would allow System banks to lower their interest rates but generally said he felt the System was not serving farm borrowers as well as it should.

Mr. Evans of Iowa said he would support the bill but expressed several concerns, including that the bill provided no incentive for the System to restructure the debts of its borrowers.

Mr. Panetta expressed concern that the Committee was in a crisis management situation and the bill would be a life jacket for the Farm Credit System. Additionally, he offered report language relating to interest rate reductions, which is contained in the section-by-section analysis section of this report.

Chairman de la Garza pointed out it is not the intention of the Committee in acting on the bill to perpetuate problems within the System and that the regulator is to be left with strong authority to oversee the System.

Mr. Evans of Iowa expressed concern that, to maintain investor confidence in the basic soundness of the System, it is important that there be full disclosure of all the financial transactions of the System.

Mr. Madigan said it was the sponsors' intention that any bank using the new accounting procedures authorized by the bill and approved by the Farm Credit Administration be required to keep dual accounting records, i.e., one under the new accounting procedures and one under their current accounting procedures.

Mr. Stenholm then received unanimous consent that the report reflect the Committee's intention that the Farm Credit Administration act as expeditiously as possible in carrying out the provisions of the bill. He added that the timeliness of resolving any request for an exemption from generally accepted accounting principles could affect the financial viability of the requesting institution and, ultimately, the System itself. The Farm Credit Administration should begin immediately promulgating any regulations required to implement the bill. The lack of timely responses from the Farm Credit Administration to System requests has been a major problem since the enactment of the 1985 Amendments. The Committee expects the Farm Credit Administration and its Chairman to administer the System's regulatory program in such a manner that the provisions of this bill are implemented as soon as possible and that the Farm Credit Administration correct unnecessary and unwarranted delays in responding to System requests and problems.

Chairman de la Garza then put the question on the reporting of the bill with the recommendation that it pass. In the presence of a quorum, the motion was agreed to by unanimous voice vote.

Administration Position

At the time of the filing of this report, the Committee had not received a report from the U.S. Department of Agriculture concerning H.R. 5635. The views of the Administration are reflected in the Committee Consideration section of this report.

Budget Act Compliance (Section 308 and Section 403)

The provisions of clause 2(l)(3)(B) of rule XI of the Rules of the House of Representatives and setion 308(a) of the Congressional Budget Act of 1974 (relating to estimates of new budget authority or new or increased tax expenditures) are not considered applicable. The estimate and comparison required to be prepared by the

Director of the Congressional Budget Office under clause 2(l)(3)(C) of rule XI of the Rules of the House of Representatives and section 403 of the Congressional Budget Act of 1974 submitted to the Committee prior to the filing of this report are as follows:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, October 3, 1986.

Hon. E DE LA GARZA,
Chairman, Committee on Agriculture,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed H.R. 5635, the Farm Credit Act Amendments of 1986, as ordered reported by the House Committee on Agriculture, October 2, 1986.

We estimate that enactment of this bill would result in no direct cost to the federal government or to state or local governments. Among other provisions, the bill would allow the formation of a new corporation within the Farm Credit System (FCS) for the purpose of redeeming high-interest bonds, thus lowering the cost of capital to FCS institutions. The bill would also remove the requirement that the Farm Credit Administration approve interest rates charged by FCS institutions. The potential budgetary effect of this bill is an indirect one and would occur only to the extent that its provision may make the FCS more or less likely to require federal assistance. Any federal assistance would require appropriations action, a requirement that H.R. 5635 would not change.

If you wish further details on this estimate, we will be pleased to provide them.

With best wishes,
Sincerely,

RUDOLPH G. PENNER, *Director.*

INFLATIONARY IMPACT STATEMENT

Pursuant to clause 2(l)(4) of rule XI of the Rules of the House of Representatives, the Committee estimates that enactment of H.R. 5635, as amended, will have no inflationary impact on the national economy.

OVERSIGHT STATEMENT

No summary of oversight findings and recommendations made by the Committee on Government Operations under clause 2(b)(2) of rule X of the Rules of the House of Representatives was available to the Committee with reference to the subject matter specifically addressed by H.R. 5635, as amended.

No specific oversight activities other than the hearings detailed in this report were conducted by the Committee within the definition of clause 2(b)(1) of rule X of the Rules of the House of Representatives.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of Rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

FARM CREDIT ACT OF 1971

* * * * * * *

POLICY AND OBJECTIVES

SEC. 1.1 (a) It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related service to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations.

(b) It is the objective of this Act to continue to encourage farmer- and rancher-borrowers participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit, and to modernize and improve the authorizations and means for furnishing such credit and credit for housing in rural areas made available through the institutions constituting Farm Credit System as herein provided.

It is declared to be the policy of the Congress that the credit needs of farmers, ranchers, and their cooperatives are best served if the institutions of the Farm Credit System provide equitable and competitive interest rates to eligible borrowers, taking into consideration the creditworthiness and access to alternative sources of credit for borrowers, the cost of funds, including any costs of defeasance under section 4.8(b), the operating costs of the institution, including the costs of any loan loss amortization under section 5.19(b), the cost of servicing loans, the need to retain earnings to protect borrower stock, and the volume of net new borrowing. Further, it is declared to be the policy of Congress that Farm Credit System institutions take action in accordance with the Farm Credit Act Amendments of 1986 in such manner that borrowers from the institutions derive the greatest benefit practicable from that Act: Provided, That in no case is any borrower to be charged a rate of interest that is below competitive market rates for similar loans made by private lenders to borrowers of equivalent creditworthiness and access to alternative credit.

* * * * * * *

TITLE I—FEDERAL LAND BANKS AND ASSOCIATIONS

PART A—FEDERAL LAND BANKS

* * * * * * *

SEC. 1.7 INTEREST RATES AND OTHER CHARGES.—Loans made by a Federal land bank shall bear interest at a rate or rates, and on such terms and conditions, as may be determined by the board of directors of the bank from time to time[, with the approval of the Farm Credit Administration as provided in section 4.17 of this Act]. In setting rates and charges, it shall be the objective to provide the types of credit needed by eligible borrowers at the lowest reasonable costs on a sound business basis taking into account the cost of money to the bank, necessary reserve and expenses of the banks and Federal land bank associations, and providing services to stockholders and members. The loan documents may provide for the interest rate or rates to vary from time to time during the repayment period of the loan, in accordance with the rate or rates currently being charged by the bank.

* * * * * * *

TITLE II—FEDERAL INTERMEDIATE CREDIT BANKS AND PRODUCTION CREDIT ASSOCIATIONS

PART A—FEDERAL INTERMEDIATE CREDIT BANKS

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SEC. 2.4 TERMS.—Loans, advances, or discounts made under section 2.3 of this Act shall be repayable in not more than seven years (fifteen years if made to producers or harvesters of aquatic products) from the time they are made or discounted by the Federal intermediate credit bank, except that the district farm credit board, under regulations of the Farm Credit Administration, may approve policies permitting loans, advances, or discounts (other than those made to producers or harvesters of aquatic products) to be repayable in not more than ten years from the time they are made or discounted by such bank. Loans, advances, and discounts shall bear such rate or rates of interest or discount as the board of directors of the bank shall from time to time determine [with the approval of the Farm Credit Administration as provided in section 4.17 of this Act], but the rates charged financing institutions shall be the same as those charged production credit associations. In setting the rates and charges, it shall be the objective to provide the types of credit needed by eligible borrowers, at the lowest reasonable costs on a sound business basis taking into account the cost of money to the bank, necessary reserves and expenses of the bank and production credit associations, and providing services to borrowers from the bank and associations. The loan documents may provide for the interest rate or rates to vary from time to time during the repayment period of the loan, in accordance with the rate or rates currently being charged by the bank. No obligation tendered for discount by a financing institution, without the approval of the Farm Credit Administration, shall be eligible for discount upon which the original borrower has been charged a rate of interest exceeding

by more than 1½ per centum per annum the discount rate of the bank.

* * * * * * *

TITLE III—BANKS FOR COOPERATIVES

* * * * * * *

SEC. 3.10. INTEREST RATES; SECURITY; LIEN; CANCELLATION; AND APPLICATION ON INDEBTEDNESS.—(A) Loans made by a bank for cooperatives shall bear interest at a rate or rates determined by the board of directors of the bank from time to time[, with the approval of the Farm Credit Administration as provided in section 4.17 of this Act]. In setting rates and charges, it shall be the objective to provide the types of credit needed by eligible borrowers at the lowest reasonable cost on a sound business basis, taking into account the net cost of money to the bank, necessry reserves and expenses of the bank, and services provided. The loan documents may provide for the interest rate or rates to vary from time to time during the repayment period of the loan, in accordance with the rate or rates being charged by the bank.

* * * * * * *

TITLE IV—PROVISIONS APPLICABLE TO TWO OR MORE CLASSES OF INSTITUTIONS OF THE SYSTEM

PART A—FUNDING

* * * * * * *

SEC. 4.8. PURCHASE AND SALE OF OBLIGATIONS.—*(a)* Each bank of the System may purchase its own obligations and the obligations of other banks of the System and may provide for the sale of obligations issued by it, consolidated obligations, or System-wide obligations through a fiscal agent or agents, by negotiation, offer, bid, syndicate sale, and to deliver such obligations by book entry, wire transfer, or such other means as may be appropriate.

(b) Through December 31, 1988, each bank of the System, in addition to purchasing obligations as authorized by this Act, may, with the prior approval of the Farm Credit Administration and subject to such conditions as it may establish, (1) reduce the cost of its borrowings by doing one or more of the following: (A) contracting with a third party, or an entity that is established as a limited purpose System institution under section 4.25 and that is not to be included in the combined financial statements of other System institutions, with respect to the payment of interest on the bank's obligations and the obligations of other System banks incurred before January 1, 1985, in consideration of the payment of market interest rates on such obligations, plus a premium, or (B) for the period July 1, 1986, through December 31, 1988, capitalizing interest costs on obligations incurred before January 1, 1985, in excess of the estimated interest costs on an equivalent amount of Farm Credit obligations at prevailing market rates of interest on Farm Credit obligations of similar maturities as of the date of the enactment of this subsection, or (C) taking other similar action; and (2) amortize, over a period of not to exceed 20 years, the capitalization of the premium, capitaliza-

tion of interest expense, or like costs of any action taken under clause (1).

* * * * * * *

PART C—RIGHTS OF APPLICANTS

* * * * * * *

SEC. 4.17. INTEREST RATES.—[Interest rates on loans from institutions of the Farm Credit System shall be determined with the approval of, as provided in section 5.17(a)(5) of this Act, the Farm Credit Administration as provided in this Act, notwithstanding any interest rate limitation imposed by any State constitution or statute or other laws which are hereby preempted for purposes of this Act.] *Interest rates on loans from institutions of the Farm Credit System shall not be subject to any interest rate limitation imposed by any State constitution or statute or other laws. Such limitations are preempted for purposes of this Act.* Interest rates on loans made by agricultural credit corporations organized in conjunction with cooperative associations for the purpose of financing the ordinary crop operations of the members of such associations or other producers and eligible to discount with the Federal intermediate credit banks pursuant to section 2.3 of this Act shall be exempt from any interest rate limitation imposed by any State constitution or statute or other laws which are hereby preempted for purposes of this Act.

* * * * * * *

TITLE V—DISTRICT AND FARM CREDIT ADMINISTRATION ORGANIZATION

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PART B—FARM CREDIT ADMINISTRATION ORGANIZATION

* * * * * * *

SEC. 5.17. ENUMERATED POWERS.—(a) The Farm Credit Administration shall have the following powers, functions, and responsibilities in connection with the institutions of the Farm Credit System and the administration of this Act:

(1) * * *

* * * * * * *

(5) Grant approvals provided for under this Act either on a case-by-case basis or through regulations that confer approval on actions of Farm Credit System institutions that meet standards criteria established by the Farm Credit Administration, including standards and criteria with respect to (A) interest rates on obligations of Farm Credit System institutions [and on loans made or discounted by such institutions], and (B) the payment of dividends or patronage refunds by Farm Credit System institutions.

* * * * * * *

SEC. 5.19. EXAMINATIONS.—(a) Each institution of the System shall be examined by Farm Credit Administration examiners at

such times as the Chairman of the Board may determine, but in no event less than once each year. Such examinations shall include, but are not limited to, an analysis of credit and collateral quality and capitalization of the institution, and appraisals of the effectiveness of the institution's management and application of policies governing the carrying out of this Act and regulations of the Farm Credit Administration and servicing all eligible borrowers. At the direction of the Chairman of the Board, Farm Credit Administration examiners also shall make examinations of the condition of any organization, other than federally regulated financial institutions, to, for, or with which any institution of the System contemplates making a loan or discounting paper. For the purposes of this Act, examiners of the Farm Credit Administration shall be subject to the same requirements, responsibilities, and penalties as are applicable to examiners under the National Bank Act, the Federal Reserve Act, and Federal Deposit Insurance Act, and other provisions of law and shall have the same powers and privileges as are vested in such examiners by law.

(b) Each institution of the System shall make and publish an annual report of condition as prescribed by the Farm Credit Administration. [Each such report shall contain financial statements prepared in accordance with generally accepted accounting principles and contain such additional information as the Farm Credit Administration by regulation may require.] *Each such report shall contain financial statements prepared in accordance with generally accepted accounting principles, except with respect to any actions taken by any banks of the System under section 4.8(b), and contain such additional information as the Farm Credit Administration by regulation may require. Notwithstanding the provisions of the preceding sentence and any other provision of this Act, for the period July 1, 1986, through December 31, 1988, the institutions of the Farm Credit system may, on the prior approval of the Farm Credit Administration and subject to such conditions as it may establish, capitalize annually their provision for losses that is in excess of one-half of one percent of loans outstanding and amortize such capitalized amounts over a period not to exceed 20 years.* Such financial statements of System institutions shall be audited by an independent public accountant.

(c) The Farm Credit Administration may publish the report of examination of any System institution that does not, before the end of the 120th day after the date of notification of the recommendations and suggestions of the Farm Credit Administration, based on such examination, comply with such recommendations and suggestions to the satisfaction of the Farm Credit Administration. The Farm Credit Administration shall give notice of intention to publish in the event of such noncompliance at least 90 days before such publication. Such notice of intention may be given any time after such notification of recommendations and suggestions.

* * * * * * *

ADDITIONAL VIEWS OF THE HONORABLE DAN GLICKMAN

With great hesitation, with more questions than answers, I supported this legislation in Committee. My uncertainty about supporting it outweighed my certainty of the need to address the unprecedented financial debacle hanging over the Farm Credit System. Indeed, just last month, the General Accounting Office testified before the Committee on Agriculture that the System may this year record a loss of $2.9 billion, topping its losses of 1985, themselves the largest losses ever posted by a financial institution in this country. GAO's report leads to the undeniable conclusion that the question facing the System, its borrowers, the Farm Credit Administration, the Treasury Department, and Congress is not whether the System may need Federal assistance, but when, what kind, and what amount.

H.R. 5635 is one form of assistance. Section 3 authorizes System institutions to lower interest rates without prior approval from the FCA. Sections 4 and 7 authorize a defeasance plan, but exempt it from generally accepted accounting principles.

The GAO report noted above provides ample documentation that the System and its institutions need to address both sides of their balance sheets. They need to improve the quality of their assets and remain competitive with other leading institutions to avoid further erosion of their ability to generate earnings. They also need to reduce losses by correcting the interest rate imbalance between their outstanding loans and debt.

At what cost compared to other alternatives, to the fundamental principles of the System, and to its integrity will the measures in HR 5635 be enacted? While the projected costs of a System failure are well established, the costs which might result from enactment of this bill, though less well defined, are no less real and no less serious.

The defeasance authorized in section 4 threatens to drive a wedge into the fundamental cooperative nature of the System. With such authority, System institutions will no longer be bound by loss-sharing arrangements designed for the strong parts of the System to aid the weaker. This undermines the intent of the Farm Credit Act as well as the amendments of 1985 to encourage the System to work together to solve its common, System-wide financial problems. Finally, this Section raises questions about the specific manner in which defeasance shall be implemented, providing little assurance that institutions which undertake such plans will be held accountable to FCA and the Congress.

Just last December, in reporting to the House on the Farm Credit Act Amendments of 1985, the Committee noted:

> The Farm Credit Administration will * * * provide for strict annual examinations of the financial conditions of

> System institutions under generally accepted accounting principles * * *. The previous method of examinations had made it difficult for the FCA, Congress, and others to determine the accurate financial condition of the System. This shortcoming has led to great uncertainty in recent months in designing a legislative response to stress in the System.

Sections 4 and 7 of this bill undo those reforms by allowing the System and its institutions an exception from generally accepted accounting principles; it has potentially enormous consequences. In addition, the scope of this exception and the manner in which it may be exercised is not detailed and, in the case of the defeasance authority, the House is not assured the System will be fully accountable for the exercise of that authority. Instead of proceeding along the course of greater independence between the System and its regulator, greater cooperation among System institutions, and greater accountability to the FCA, Congress, borrowers, and investors established under the 1985 amendments, these provisions reverse course.

Finally, while the record substantiates the need for action, there exists little record of the appropriateness and desirability of the approach in H.R. 5635 and even less of a record the legislation's change will indeed benefit System borrowers.

In considering the bill, I put to my colleagues the same question I faced: Do your uncertainties about the legislation outweigh your certainties about the problem?

DAN GLICKMAN.

SEPARATE VIEWS OF HON. COOPER EVANS

It is with great reluctance that I support the Farm Credit Act Amendments of 1986. I am disturbed with both the substance of this legislation and the manner in which it is being brought before us. To push this absolutely crucial legislation through Committee at the end of the session in a late afternoon mark-up without providing an opportunity for most Members to fully understand it, let alone to offer constructive amendments, is irresponsible, an embarrassment to this body and a disservice to the farm constituency which we serve.

I note with interest that when this legislation was introduced it was titled "The Farm Credit System Borrower Interest Rate Relief Act". That title has been changed, and I think appropriately so, to simply "The Farm Credit Act Amendments of 1986". I suspect there are still those who have been mislead by the original title; who still believe this act will alleviate some of the economic pain in farm country. That is simply not true. This bill, as written, does nothing to help the farmer. It does nothing to encourage debt restructuring or to provide interest-rate relief to Farm Credit System borrowers.

Furthermore, I believe there are provisions within this bill which, if not implemented in a responsible manner, will mislead the investment community. This could someday result in a serious loss of investor confidence. To precipitate a loss of investor confidence in Farm Credit System bonds is the fastest way I know to bring the entire System crashing down around our feet.

There are a number of changes I would like to see made in this legislation. My first concern deals with ways in which this bill could be amended to bring some long-awaited relief to System borrowers. Assurances need to be built into the legislation which require that any reductions in the cost of funds occurring as a result of its implementation will be passed along to borrowers. By doing so, we can help make lower interest costs a reality for our producers in the coming 1987 crop year. We should insist on complete and accurate reporting of the extent to which benefits that accrue due to lowering the System's cost of funds are passed along to borrowers and the extend to which those savings are used for other purposes.

I am also concerned that reductions in the cost of System funds will not be passed along to borrowers with nonaccrual loans. We have done nothing to make it more attractive for the System to restructure debt rather than to foreclose. I favor lengthening the time over which System banks may write off losses when a bank agrees to restructure nonaccrual loans. In addition, Farm Credit System banks should be required to use the Farmers Home Administration's guaranteed loan program as an additional means to avoid foreclosure.

The second major area of concern I have with this bill is the effect that some of our newly implemented accounting trickery will have on investors confidence. The last thing any of us needs is to find an early morning surprise in the Wall Street Journal one day describing in detail just what has been going on in the back room with the Farm Credit System books.

The idea of allowing the use of defeasance to reduce the high coupon bonds in the System's portfolio is a good one. This bill, however goes too far in allowing the amortization of loan losses as well as the premiums on those high cost bonds. Instead of simply lowering the cost of those bonds, we are permitting the System to write off loan losses over twenty years. This gives a false picture of the System's true financial condition.

In the amortization of premiums on the bonds, I am concerned that there is no provision to ensure that this is done uniformly over the amortization period.

Another area of concern I have is that the System be specifically authorized to issue bonds that are due on call. Although it is presumed to have this authority, it has not been used, partially because of the threat of legal challenges to it. I believe that Congress should make clear its intent that the System have the option of issuing callable bonds when its in the stockholders' best interest. If this authority had been used, the System would now be able to significantly reduce the amount of its high-cost bonds.

I have strong reservations about this bill and the manner in which it has been handled. While this legislation has the honorable intent of helping the Farm Credit System borrowers by lowering interest rates, what it really does is prolong the inevitable day in which the System goes, hat in hand, to the Federal Treasury for a bailout. Again, this legislation is an attempt at System survival, not borrower relief.

COOPER EVANS.

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